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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-1474

THE SUPERIOR OIL COMPANY,

Petitioner,

v.

FEDERAL POWER COMMISSION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioner, The Superior Oil Company ("Superior"), petitions for a writ of certiorari to review the Judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The Opinion of the Court of Appeals for the Fifth Circuit, issued October 14, 1975, is reported at 520 F.2d 1061 and its *per curiam* Order denying this Petitioner's Petition

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for Rehearing, issued January 14, 1976, is reported at 525 F.2d 1261, which Opinions are reproduced in The Chevron Appendix[1] as Appendices A and B, respectively. The initial Order (Opinion No. 699) of the Federal Power Commission ("FPC" or "Commission") is reported at 51 F.P.C. 2212 and its Order (Opinion No. 699-H) denying rehearing is not yet reported, but such Orders are reproduced as Appendices C and D, respectively. (See note 1, *supra*).

JURISDICTION

The Judgment of the Court of Appeals was entered on October 14, 1975 and its Order denying this Petitioner's Petition for Rehearing was entered January 14, 1976. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTIONS PRESENTED FOR REVIEW

1. Whether the Federal Power Commission can require a producer to enter into replacement or renewal contracts in order to qualify for the new national gas rate for continued deliveries of natural gas in situations where sales were formerly made pursuant to permanent certificates of public convenience and necessity of unlimited duration under contracts which have expired by their own terms.
2. Whether the Commission can deprive a natural gas company of part of a just and reasonable rate fixed on one date for the purpose of being privileged to collect a higher just and reasonable rate fixed on a later date.

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[1] In the interest of simplicity, each party filing a Petition for Certiorari has agreed to utilize the Appendix of The California Company, a division of Chevron Oil Company, who is also a Petitioner for a Writ of Certiorari herein, which Appendix contains the opinions below, the FPC opinions, and the statutes involved, denominated as Appendices A through E therein for the reprinting of such material. All references to the Appendix or Appendices are to that document.

STATUTES INVOLVED

Sections 4, 5, 7 and 19 of the Natural Gas Act of 1938, 52, stat. 821-833, as amended, 15 U.S.C. Sections 717c, 717d, 717(f) and 717(r) are involved and are reproduced in Appendix E (See note 1, *supra*).

STATEMENT OF THE CASE

Federal Power Commission (Commission) Opinion Nos. 699 and 699-H require, in effect, the execution of a *renewal or replacement contract* in situations where a natural gas sales contract between a producer (under the definition of "a natural gas company" and subject to the jurisdiction of the Commission, under the Natural Gas Act, 15 U.S.C. § 717) and a pipeline transporter has expired in order for the producer to be granted the new national rate for continued sales of natural gas. The Fifth Circuit Court of Appeals, in its Opinion rendered October 14, 1975, in the captioned cause, upheld the Commission's authority to require such renewal contracts, apparently in the belief that Congress, in addition to vesting the Commission with its primary regulatory function of determining just and reasonable rates for natural gas, has also granted the Commission authority to dictate other non-price contractual relationships between producer and pipeline.

In addition, in Opinion Nos. 699 and 699-H, the Commission also provided that natural gas sold at the new national rate could not be used by producers to "work off" refund obligations, the right to which was granted them in previous area rate proceedings. The Fifth Circuit held that the new national rate structure was a product of an independent determination of incentives, not tied to previous determinations, and that replacing one incentive system with another is a proper exercise of Commis-

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sion discretion and does not amount to retroactive rate regulation.

Superior objected to these two aspects of the Fifth Circuit's October 14, 1975 Opinion, and accordingly, filed its Petition for Rehearing on November 17, 1975, which Petition was denied by *per curiam* order of the Court rendered January 14, 1976. Superior herewith files its Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit for review of the issues presented.

REASONS FOR GRANTING THE WRIT

Federal Power Commission Opinion Nos. 699 (issued June 21, 1974) and 699-H (issued December 4, 1974) established a nationwide rate, at a base price of 50 cents per Mcf, for new gas, and further provided for a revision upward of an additional one-cent increase effective January 1, 1975. In addition, to the base ceiling rate, the Commission allowed the ceiling rate to be increased by the amount of state or federal severance or production taxes, or similar taxes, by an upward or downward Btu adjustment from a base of 1,000 Btu per cubic foot, and by gathering increments varying between production areas.

The new national rate for natural gas was promulgated by the Commission after express findings that the nation was experiencing a severe natural gas shortage, that the magnitude of the exploration and development effort required to elicit new supplies of domestic natural gas to offset the shortage and fulfill reasonable future demands was staggering, that the necessary effort required massive capital commitments, and that, therefore, it was the Commission's regulatory obligation to establish a uniform national rate that provided the incentives to stimulate and encourage the unprecedented exploration and development effort.

(Appendix C, pages 19-28). In furtherance of that regulatory obligation, the 699 series of Opinions extended the new national rate to those situations where natural gas deliveries were continued by a producer pursuant to permanent certificates of public convenience and necessity of unlimited duration under contracts which have expired by their own terms if, and only if, the producer and pipeline transporter entered into a renewal contract. In other words, without the required renewal contract in these situations, the producer was denied the "just and reasonable" new national rate and was required to continue delivery and sale of the gas at the old rate.

Superior objected to the *renewal* or *replacement* contract requirement on the grounds that (1) that the Commission was without legal authority under the Natural Gas Act to make such a requirement, (2) that it was anti-competitive, and (3) that such a condition violated Section 4(b) of the Act. The Commission rejected Superior's arguments stating:

> ". . . . In many cases, the purchasing pipeline may desire a *quid pro quo* from the selling producer in the form of additional acreage dedication, exploration and development activity on the previously dedicated acreage or other similar activities that could result in the dedication of additional new gas supplies to the interstate market. Such concessions by the seller will certainly not be made if the price is allowed to increase to the national rate automatically without the requirement of a renewal contract. Since such concessions are in the public interest because of the need for additional gas supplies which can be dedicated to interstate pipelines, it would be untenable to force the purchasing pipeline to pay the increased rate without the opportunity to obtain additional benefits for itself and its customers.
>
> "Finally, we find no merit to Superior's contention, made at the oral argument in this proceeding, that the

requirement of a renewal contract violates section 4(b) of the Natural Gas Act. No evidence was made a part of the record of this proceeding which would support such an argument, and, in the absence of such evidence, we are constrained to reject the argument. . . ." (Citations omitted. Opinion 699, App. D, pp. D-45, D-46)

The Court of Appeals, without an analysis of either the Natural Gas Act or the case law established by prior decisions of this Court, followed the rationale of the Commission and in its October 14, 1975 Opinion, and declared:

". . . . From these facts it reasoned that the national rate structure should be functionally applied to provide some of these funds, placing the burden not just on 'new' gas but also on flowing gas for which the primary contract had expired. In so doing the Commission recognized that natural gas is an exhaustible commodity and expressed its belief that today's consumers should share the burden of finding replacement supplies for the supplies which are being exhausted by the consumers.

"Furthermore, the Commission does not consider the matter finally determined. It has expressly reserved for consideration in the biennial review the question of whether the pipelines are negotiating in good faith or trying to take advantage of the producer's locked-in position, and whether or not the additional funds generated by the application of the new rate increase 'the level of monies committed to exploration and development programs and the volumes of new gas supplies dedicated to interstate pipelines under long-term contracts.' The Commission has thus remained flexible and is prepared to adjust the national rate structure as necessary. The Commission has struck a tentative balance between the consumer and the investor interests and stated that it is prepared to reevaluate the equilibrium it sought to achieve in the biennial review. Under such a circumstance, no party has carried the heavy burden of showing that the Commission's bal-

> ance is tilted so far in either direction as to be unjust and unreasonable in its consequence. We also consider the decision, although not compelled by the evidence, to be supported by the substantial evidence of a shortage and the need for a massive infusion of funds." (Appendix A, p. A-30. Citations omitted.)

As shall be demonstrated below, the requirement of renewal contracts as a condition precedent to the application of the new national rate is outside the scope of the Commission's legal authority as set forth in the Natural Gas Act and as unequivocably interpreted by this Court.

In addition, in Opinion Nos. 699 and 699-H, the Commission also provided that natural gas sold at the new national rate could not be used by producers to "work off" refund obligations, the right to which had been granted them in previous area rate proceedings. In doing so, the Commission declared:

> "... This treatment is equitable since the rates established in those opinions were determined to be sufficient to encourage exploration and development activities when coupled with the refund credit incentives and contingent escalations provided in those opinions. To allow producers to collect the rate provided by this decision and to discharge their existing obligations and receive the benefits provided under the applicable area rate opinions with the same supplies of natural gas would be contrary to the spirit of the applicable area rate opinions. In essence, we seek to insure that a producer will not receive a double benefit from the rate structure which we establish in this decision." (Citations omitted. Appendix C, p. C-110.)

Superior, as did other producers, argued that such a provision constituted an improper retroactive modification of prior opinions and as such, deprived it of vested

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rights. The Court of Appeals, without making any distinction between "old" (i.e. "flowing") gas rates and "new" gas rates as the same were applied in the previous rate proceedings and without, apparently, understanding the difference between *refund credits* and *contingent escalation* provisions of the previous area proceedings, declared:

> ".... By its orders which are here at issue, the FPC has established a new rate system for gas dedicated in interstate commerce after January 1, 1973, in addition to gas from certain other sources. The new national rate is the product of an independent determination of incentives, and, as it is in so many other regards, the new rate structure is not tied to previous determinations. Replacing one incentive structure with another or, viewed in another light, providing a new alternative rate system, is an exercise of Commission discretion which does not amount to retroactive rate regulation. See *Moss* v. *FPC*, 164 U.S. App. D.C. 1, 502 F.2d 461 (1974)." (Citation by Court. Appendix A, p. A-42.)

As shall be demonstrated below, the Court of Appeals was misled by *Moss*, *supra*, and failure to retain the refund credits is tantamount to retroactive rate regulation.

No argument is presented with respect to the other provisions of the October 14, 1975, Opinion of the Court of Appeals.

I. ARGUMENT ON ISSUE ONE

A. As a Practical Matter, Upon the Expiration of a Gas Sales Contract According to Its Terms, Abandonment Under Section 7(b) Is Not Available, Absent Depletion.

Carefully bearing in mind that the primary holding of the Court of Appeals below was to approve the establishment of a national rate for jurisdictional well head

sales of gas, based upon its recognition of substantial evidence of a natural gas shortage and the need for a massive infusion of funds,[2] the Court is respectfully requested to examine the situation which arises upon the expiration date of a natural gas sales contract.

Section 7(b) of the National Gas Act[3] governs the duties and obligations of a natural gas company as follows:

> "(b) No natural-gas company shall *abandon* . . . any service . . . without the permission and approval of the Commission . . . after due hearing, and a finding by the Commission that . . . the supply of natural gas is *depleted* . . . or that the present or future public convenience or necessity permit such *abandonment*."[4] (Emphasis added.)

Thus, in an expired contract situation, the natural gas company has no further *contractual* commitment to supply gas at the contract price, but it is nonetheless prohibited from discontinuing service except in accordance with the provisions of Section 7(b) above relating to depletion or abandonment. As it is recognized by all concerned that there is presently a severe shortage of natural gas in this country, there is little ground to expect a finding by the Commission under Section 7(b) that "present or future public convenience or necessity" would permit such an abandonment, absent depletion, even in the presence of a competing market situation (i.e. two or more pipelines) where presumably a *greater* need for natural gas (at higher prices) could be demonstrated by one pipeline distributor over another (or others in the area). Certainly, this would be the case, absent depletion, in a single market situation (i.e. where only one pipeline is available).

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[2] Shell Oil Co., et al. v. FPC and Related Cases, National Rate Cases for New Gas, 520 F.2d 1061 (1975), Appendix A.
[3] 15 U.S.C. § 717f.
[4] 15 U.S.C. § 717f(b).

B. The Commission Has No Legal Authority to Require a Producer and a Pipeline to Enter Into A Contractual Relationship.

Therefore, as a practical matter, upon the expiration of a gas sales contract according to its terms, abandonment under Section 7(b) of the Natural Gas Act is not available, absent depletion. Thus, in such a situation, a producer presently finds itself in the position of being required to continue delivery of gas at the old rate under the provisions of Section 7(b) of the Act, which rate, in the light of Opinions 699 and 699-H, is no longer "just and reasonable."

The situation described above is one which will become more and more common for the reason that during the 1953-1956 time period, Superior, as did many other producers, executed numerous twenty-year natural gas sales contracts which have either terminated or will soon terminate, by their own terms. The Commission, in Opinions 699 and 699-H, has established a new national rate as the "just and reasonable" rate to apply in these expiring contract situations, but only if the parties enter into a *renewal* or *replacement contract*. In imposing this latter condition, it is abundantly clear that the Commission has exceeded its statutory authority under the Natural Gas Act, not only under the literal wording thereof, but also under unequivocal interpretations thereof by this Court in *Federal Power Commission* v. *Sierra Pacific Power Co.*[5] and *United Gas Pipe Line Co.* v. *Mobile Gas Serv. Corp.*[6]

In *United* v. *Mobile*, *supra*, this Court declared:

"... [T]he Natural Gas Act permits the relations between the parties to be established initially by con-

[5] 350 U.S. 348, 76 S.Ct. 368 (1956)
[6] 350 U.S. 332, 76 S.Ct. 373 (1956)

> tract, the protection of the public interest being afforded by supervision of the individual contracts, which to that end must be filed with the Commission . . . ." (Opinion, page 378, left column.)

Under *United* v. *Mobile*, *supra*, the relationship of the parties, contractual or otherwise, is initiated and established by and between the parties themselves, subject to and as limited by the supervisory and regulatory powers of the Commission under the Natural Gas Act. Absent an existing contract rate obligation, a producer is free to unilaterally change, and increase if the situation so warrants, the rate schedule to a given pipeline, subject to the review of the new rate by the Commission according to its "just and reasonable" standards.

In *United* v. *Mobile*, *supra*, this Court also declared:

> "The powers of the Commission are defined by §§ 4(e) and 5(a). The basic power of the Commission is that given it by § 5(a) to set aside and modify any *rate* or *contract* which it determines, after hearing, to be 'unjust, unreasonable, unduly discriminatory, or preferential.' This is neither a 'rate-making' nor a 'rate-changing' procedure. It is simply the power to review *rates* and *contracts* made in the first instance by natural gas companies and, if they are determined to be unlawful, to remedy them. Section 5(a) would of its own force apply to *all* the *rates* of a natural gas company, whether long-established or *newly changed*, but in the latter case the power is further implemented by § 4(e)." (Opinion, p. 379, right column. Emphasis added, except "all").

With regard to the limitations imposed on natural gas companies by Section 4(c) and 4(d) of the Natural Gas Act, this Court further declared:

> "The basic duties are the filing requirements: § 4(c) requires schedules showing all *rates* and *contracts*

in force to be filed with the Commission and § 4(d) requires all changes in such schedules likewise to be filed . . . . It may readily be seen that these requirements are no more than necessary to implement §§ 4(c) and 5(a) . . ." (Opinion, p. 379, right column. Emphasis added.)

"Section 4(d) provides not for the filing of 'proposals' but for notice to the Commission of any 'change . . . made by a natural gas company, *and the change is effected, if at all, not by an order of the Commission but solely by virtue of the natural gas company's own action.*" (Opinion, p. 380, left column. Emphasis added.)

"The obvious implication is that, except as specifically limited by the Act, the rate-making powers of natural gas companies were to be no different than those they would possess in the absence of the Act: to establish *ex parte*, and change at will, the rates offered to prospective customers; or to fix by contract, and change only by mutual agreement, the rate agreed upon with a particular customer." (Opinion, p. 380, right column.)

In *Federal Power Commission* v. *Sierra Pacific Power Co.*,[7] *supra*, the companion case decided the same day as *United*, *supra*, by this Court, it was acknowledged that the case presented questions under Title II of the Federal Power Act, 49 Stat. 16 U.S.C. § 824 et seq., 16 U.S.C.A. § 824 et seq., similar to those which the Court decided under the Natural Gas Act, 15 U.S.C.A. § 717 et seq. in *United*, *supra*. Further, the Court also acknowledged that the pertinent provisions of the Federal Power Act §§ 205(c), (d) and (e), and 206(a), and that these sections were substantially identical to §§ 4(c), (d), and (e), and 5(a), respectively, of the Natural Gas Act.[8]

Under the facts of that case, Pacific Gas and Electric (PG&E) had offered Sierra a 15-year contract for power

[7] 350 U.S. 348, 76 S.Ct. 368 (1956)
[8] Opinion p. 369, right column.

at a special low rate in order to forestall competition. The offer was accepted in 1948 and filed with the Commission. Scarcely 5 years later (i.e., during the term of the contract) when there was no longer any threat of competition, PG&E, without Sierra's consent, filed a 28% rate increase schedule with the Commission. The Commission ultimately held the new rate not to be "unjust, unreasonable, unduly discriminatory, or preferential" and refused to grant Sierra's motion to reject the filing. On Sierra's petition for review, the Court of Appeals for the District of Columbia, holding that the contract rate could be changed only upon a finding by the Commission that it was unreasonable, set aside the Commission's order and remanded the case with instructions to the Commission to dismiss the § 205(e) proceedings, but without prejudice to its instituting a new proceeding under § 206(a) to determine the reasonableness of the contract rate. (The corresponding sections of the Natural Gas Act are §§ 4(e) and 5(a), respectively.)

The Court was here concerned with the standard used by the Commission in determining the justness and reasonableness of the existing *contract rate* as that standard related to the public interest as distinguished from that of the public utility company. The Court was also concerned about the related question of the parties' freedom to contract under circumstances where the public interest was not at issue. As to these aspects of the case, the Court declared:

> "... But, while it may be that the Commission may not normally *impose* upon a public utility a rate which would produce less than a fair return, it does not follow that the public utility may not itself agree by contract to a rate affording less than a fair return or that, if it does so, it is entitled to be relieved of its improvident bargain.... In such circumstances the sole concern of the Commission would seem to be whether the rate is so low as to adversely affect the

> public interest — as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory. That the purpose of the power given the Commission by § 206(a) is the protection of the public interest, as distinguished from the private interests of the utilities, is evidenced by the recital in § 201 of the Act that the scheme of regulation imposed 'is necessary in the public interest' . . ." (Citations omitted. Opinion, p. 372, right column.)

Bearing in mind that § 206(a) of the Federal Power Act corresponds to § 5(a) of the Natural Gas Act, *Sierra*, *supra*, clearly holds that the legitimate function of the Commission's regulatory review is to determine whether rates and contracts are "just and reasonable" as that standard relates to the public interest and not to protect the private interest of a public utility company. As the Commission has established the "just and reasonable rate" to be the new national rate in Opinions 699 and 699-H, it should be merely perfunctory for the Commission to approve a new higher rate at that level without requiring a renewal contract to protect a pipeline distributor.

In attempting to impose an obligation on the parties to enter into a renewal contract in order for the producer to receive the new national rate in the expired contract situation, it would seem that the Commission is attempting to act as "referee" for the parties to insure that each bargains in "good faith" so that each may obtain a *quid pro quo* for entering into a renewal contract and thus obtain a contractual relationship that is "mutually beneficial." This is absurd. Neither the producer nor the pipeline is at the mercy of the other in an expired contract situation. The producer is entitled to increase the rate upon expiration of the contract, but only to the extent that the newly changed and increased rate is a "just and reasonable" rate

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as ultimately determined by Commission review to be in the public interest.

The basic power of the Commission is to set aside and modify any *rate* or *contract* which it determines, after hearing, to be "unjust, unreasonable, unduly discriminatory, or preferential." Section 5(a) of the Natural Gas Act, *supra*. The filing requirements for a producer with a *newly changed rate* in the expired contract situation and the Commission's regulatory obligation to review the new rate are clearly set forth in the Natural Gas Act. Similarly, this Court has, equally clearly, interpreted the applicable provisions of the act in *United* v. *Mobile*, *supra*, and *FPC* v. *Sierra*, *supra*. The Court of Appeals simply failed to heed the mandates prescribed by this Court in those cases. Therefore, the Commission's action in requiring renewal contracts is not only "unjust and unreasonable," but patently outside the scope of its authority and therefore unlawful.

C. The Requirement of a Renewal Contract in the Expired Contract Situation Is Anti-Competitive in Nature.

Alternatively, the Court is once again asked to look at the situation that arises in the expired contract situation where two or more pipeline transporters would otherwise be competing for a producer's post-contract gas supply. If the producer cannot make a unilateral adjustment in the rate in order to obtain the new national rate, the producer may opt to (1) enter a renewal contract with its previous customer (the path of "least resistance"), or (2), assuming a better deal could be made with a new customer having a greater need for the remaining gas supply, initiate a protracted § 7(b) abandonment proceeding, which, as the Court of Appeals acknowledged in its Opinion below, is costly both in terms of time, while the lower rate is being re-

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ceived, and in terms of money to prosecute the abandonment.[9] However, both the Court of Appeals and the Commission have failed to recognize the anti-competitive nature of the renewal contract in this siuation.

In *Transcontinental Gas Pipe Line Corp.* v. *Federal Power Commission*,[10] the Court of Appeals for the District of Columbia held that where two competing pipelines need gas supplies, the party having a contractual right to such gas will not necessarily prevail and that a "comparative needs" standard must be applied. In the course of its opinion, the Court (citing *Michigan Consolidated Gas Co.* v. *FPC*, 108 U.S. App. D.C. 409, 283 F.2d 204, cert. denied, 364 U.S. 913, 81 S.Ct. 276 (1960)), declared:

> "The fundamental tenets established by *Michigan Consolidated* are that the public interest is the ultimate criterion under § 7(b) and that all factors relevant to the determination of which course of action best promotes the overall public interest must be fully considered. The Commission there proposed, and this court accepted, a comparative needs test which balanced the relative needs of the competing pipelines and their ultimate consumers as the principal index of the public interest." (Opinion, p. 1328, right column.)
>
> "... Rigid deferral to contractual arrangements without a searching inquiry into other factors relevant to the public interest as required by § 7(b) simply is an inadequate means to assure vindication of the transcendant interests of the public." (Opinion, p. 1329, left column.)

Clearly then, the renewal contract requirement would seem to be for the primary benefit of the pipeline distributor whose contract with its producer-supplier has just expired, apparently in preference over and without regard to the

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[9] Opinion, Appendix A, page A-28.
[10] 488 F.2d 1325 (D.C.Cir., 1973).

needs of a competing pipeline and its customers. Therefore, the renewal contract requirement is anticompetitive by its very nature.

D. Requirement of a Renewal Contract Violates Section 4(b) of the Natural Gas Act.

By comparison, if a producer has previously supplied service to two different pipelines, to one under a rate schedule found by the Commission to be just and reasonable and without benefit of contract, and to the other pursuant to a permanent certificate of convenience and necessity under a contract, which has expired and remains unrenewed, Opinion Nos. 699 and 699-H would seemingly permit the new national rate to be applied to the former and not the latter. Such preferential and advantageous treatment would be discrimination in direct violation of the unequivocally clear provisions of Section 4(b) of the Natural Gas Act.

> "No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue *preference or advantage* to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any *unreasonable* difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service." (Emphasis added.)

The Commission rejected oral argument of Superior to this effect when this proceeding was before the Commission on the ground that it was not supported by the evidence. What evidence is necessary? It cannot be denied that under the fact situations presented, Opinions Nos. 699 and 699-H, to the extent that they permit the new national rate to apply to one situation and not the other, requiring only a renewal contract to distinguish them, are arbitrary

and clearly place Superior in danger of violating Section 4(b) in abiding by them.

II. ARGUMENT ON ISSUE TWO

A. The Commission's Requirement of a "Waiver" of the Refund Credits Under Previous Area Rate Proceedings in Order to Qualify for the New National Gas Rate Deprives Producers Entitled to Same of Vested Rights.

The Court of Appeals in its October 14, 1975, Opinion fails to make the necessary distinction between "flowing" (i.e. "old") gas rates and "new" gas rates as the same were applied in the previous area rate proceedings[11] in developing the refund credit concept. In its Opinions in those prior proceedings, the Commission included provisions permitting those producers who had incurred refund obligations as a result of Commission determinations of just and reasonable rates for "old" (i.e. "flowing") gas could, instead of actually refunding the amount in cash, elect to "work-off" their refund obligations by the commitment of additional new gas reserves to the interstate market at the just and reasonable rate for *new* gas. The Commission's formula in Southern Louisiana II[12] worked as follows: Any company with a "refund obligation" to any natural gas pipeline company purchasing "flowing" gas at just and reasonable rates established by the Commission for same is allowed to reduce the refund obligation by one cent for each Mcf of *new* gas reserves committed in the Southern Louisiana Area to the interstate market during the period

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[11] *Texas Gulf Coast Area Rate Case*, 45 F.P.C. 675, 18 C.F.R. Section 154.09; *Southern Louisiana Area Rate Case*, 46 F.P.C. 86, 18 C.F.R. Sec. 154.195; *Other Southwest Area Rate Case*, 47 F.P.C. 99, 18 C.F.R. Sec. 154.109(a); and *Permian Basin Area Rate Case* (II), 50 F.P.C. 313.

[12] 46 F.P.C. 86, 147-48.

ending October 1, 1977. Any portion of the "refund obligation" not so discharged is payable in cash, with interest.

First, it is imperative for the Court to understand that the refund discharge obligation provisions were attributable to the "flowing" gas rate. In Southern Louisiana II,[13] the Fifth Circuit Court of Appeals found that the refund discharge provision was attributable to the "flowing" gas rate, which was the ceiling rate (i.e. "the just and reasonable" rate established by the Commission) which established the refund obligation in the first place. There the Court of Appeals specifically approved the use of incentive provisions in the "flowing" gas rate, with the following language:

> "Because the flowing gas rates which many of the producers in SLA have been collecting subject to refund in the past exceeded the rates determined to be 'just and reasonable' by FPC in Op: 598, FPC ordered substantial refunds to remedy the over-charge. From a supply-oriented perspective, however, FPC also realized that refunding was a significant disincentive for current and future exploration and development and a possible impairment of the current capital situation of many companies. Accordingly, Op: 598 adopted a procedure to allow those producers owing refunds to cancel their refund obligations by committing new gas reserves to jurisdictional sales in SLA." (Citation omitted. Opinion, page 902, right column)

In short, in the previous area rate proceedings, "old" (i.e. "flowing") and "new" gas each bore part of the incentive burden to spur additional exploration and development: the "new" gas by a new higher rate and the "old" (i.e. "flowing") gas by reduction of the refund obligations owing with respect thereto under a formula based upon

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[13] *Placid Oil Company* v. *Federal Power Commission*, 483 F.2d 880 (5th Cir., 1973).

the addition of new reserves in the Southern Louisiana Area committed to the interstate market. In declaring this to be so, this Court sustained the Opinion of the Fifth Circuit in *Mobil Oil* v. *F.P.C.*[14] by the following language:

> "As between placing the burden of that expansion on new or second vintage gas alone or spreading it over both old and new gas, it judged the latter more equitable and more likely to lead to the immediately increased capital necessary in the face of a crisis." (Opinion page 2351, right column)

Secondly, consideration should be given to just what the "work-off" credits meant to the capital structures of the producers. The refund obligations were certain in amount and, absent the work-off credits, payable in cash, with interest. By providing the producers with a means to "work-off" these refund obligations other than by direct cash payments, the **capital structures of the producers** were increased by **a measurable amount**, i.e. the total of the refund obligations, which additional capital was needed for future exploration and development. In being thus relieved of immediate cash obligations in measurable amounts, the producers acquired thereby a *vested interest* in the means of delivery; i.e. the "work-off" credits.

Thirdly, it must be remembered that Commission Opinions 699 and 699-H were rendered in a proceeding which is limited to rates for "new" gas after January 1, 1973 and do not purport to deal with the rate structure applicable to "flowing" or "old" gas established in previous area rate proceedings. The "flowing" gas rates were deferred to another Commission docket, Docket R-478. No change is made in the decisions issuing from Opinions 699 and 699-H in the ceiling rate for "flowing" gas. Hence, any new determination of incentives established by the new

[14] 417 U.S. 283, 94 S.Ct. 2328 (1974).

national rate for expansion of exploration and development should properly be related solely to sales of "new" gas after January 1, 1973. To the extent the Commission has taken a position to the contrary, it is in error. To the extent the Fifth Circuit has interpreted the establishment of the national rate as supplanting incentives relating to the rate for "flowing" or "old" gas under previous area rate proceedings, it is mistaken.

Fourthly, it is apparent that the establishment of the new national rate as a just and reasonable rate for "new" gas sales after January 1, 1973 is clear evidence of the fact that the "new" gas ceiling rates established in previous area rate proceedings are, by reason of the determinations in Opinions 699 and 699-H, no longer "just and reasonable." Phrased another way, it has become necessary to increase the incentive burden to be borne by "new" gas sales.

In Opinion Nos. 699 and 699-H, the Commission has provided the producers with the "opportunity" to elect either to continue to utilize the provisions in the area rate decisions for refund obligation discharge, and receive approximately only one-half of the present just and reasonable rate for "new" gas, or they may "waive" the refund discharge provisions and sell their "new" gas at the present just and reasonable rate (i.e. the new national rate). In the first instance, current "new" gas sales are denied a just and reasonable rate; in the second, "flowing" or "old" gas sales are denied a just and reasonable rate. Obviously, it is a legal wrong to deprive a natural gas company of part of a just and reasonable rate fixed on one date for the purpose of being privileged to collect a higher just and reasonable rate on a later date.

As demonstrated previously herein, the refund discharge provisions are tied solely to the "just and reasonable"

incentive burden to be borne by "flowing" or "old" gas as established in the area rate proceedings. The producers in acquiring additional capital for expansion of exploration and development that would otherwise have been needed to discharge the refund obligations in cash, have *vested rights* in the "work-off" refund discharge provisions. Any required "waiver" to effect a just and reasonable rate for new gas deprives the producer of such *vested rights* and therefore is tantamount to an illegal *retroactive rate order*, contrary to the express provisions of Section 5(a) of the Natural Gas Act, which provides:

> "... [T]he Commission shall determine the just and reasonable rate, charge, classification, ... to be *thereafter observed and in force...*" (Emphasis added.)

This is not the case with contingent escalation provisions in area rate orders, as shall be pointed out below.

B. Waivers of Contingent Escalation Provisions in Area Rate Orders Do Not Deprive Producers of Vested Rights and Are Readily Distinguishable from Refund Credits.

In its October 14, 1975, Opinion, the Fifth Circuit Court held that the provisions of Opinion Nos. 699 and 699-H, to the effect that natural gas sold at the new national rate could not be used (1) to discharge refund obligations or (2) to trigger contingent escalations, were not improper retroactive modifications of prior rate opinions. The Court declared that "replacing one incentive structure with another, or viewed in another light, providing a new alternative rate system, is an exercise of Commission discretion which does not amount to retroactive rate regulation" and cited *Moss* v. *F.P.C.*, 164 U.S. App. D.C., 502 F.2d 461 (1974) as supporting authority.

In so holding, the Court failed to properly distinguish between *work-off credits* to discharge refund obligations certain in amount from *contingent escalation clauses* and the net economic impact of each on the capital structure of a producer.

In *Moss, supra*, the Commission in its Order No. 455 dated August 3, 1972, entitled "Statement of Policy Relating to Optional Procedure for Certifying New Producer Sales of Natural Gas," declared its intent to provide two incentives to spur exploration and development by (1) certification of sales of gas not previously deliverable to the interstate market at prices which are shown to be in the public interest and (2) lessening rate uncertainty.

Significantly, the Court, quoting Order No. 455 extensively, declared in *Moss, supra:*

> "Recognizing 'the supremacy of Section 5' of the Natural Gas Act, 'that Section 5 . . . prevents the Commission from granting sanctity of contract' and that it could not 'bind a future Commission not to invoke the *prospective* operation of Section 5' the Commission announced its 'policy to examine the justness and reasonableness of proposed rates in Section 7 proceedings instituted under this Section, thus avoiding the uncertainty of reserving rate determinations for subsequent Section 4 or Section 5 action.' With this preface the Commission promulgated the new Section 2.75 of its Rules of Practice and Procedure, General Policy and Interpretations." (Emphasis added. Opinion, page 464, right column.)

In pertinent part, the Court also stated:

> "Section 2.75 provides that by accepting a certificate under the optional procedure the seller-applicant unconditionally agrees to waive all rights to contingent adjustment of flowing gas rates as provided by the Commission in area rate decisions (*Southern Louisiana*

> *II and Texas Gulf Coast*) for *flowing gas* which the seller-applicant produces in the same geographical pricing area as the pricing area of the production covered by the application." (Emphasis added. Opinion, page 469, right column.)

Thus, the proposed new Section 2.75 set up a procedure whereby the Commission would certificate *new* sales of natural gas under contracts executed on or after April 6, 1972, under which applications for certification of such new sales might be tendered by parties to a contract and would be considered for permanent certification, notwithstanding that the contract rate might be in excess of a ceiling rate established in a previous area rate proceeding. The rates thus established would not be subject to change in later proceedings and the certification would constitute a final determination under Section 7 of the Natural Gas Act as required by the present and future public convenience and necessity.

The Court in *Moss, supra,* felt that the optional procedure provided by Order 455 of the Commission was reasonable and quoted the Commission as follows:

> "By retaining [the] paragraph . . . we require, in effect, an election by producers with flowing gas in Southern Louisiana and Texas Gulf Coast; they must choose whether contingent escalations on flowing gas provide a sufficient incentive to seek and sell new gas to the interstate market, at area rates, or whether a greater degree of market freedom in the pricing of new supplies offsets the benefit of contingent escalation of flowing gas prices. Requiring this election protects the consumer, as we must, from escalation of both flowing and new gas rates."[15] (Opinion, page 470, left column.)

Thus, the "waiver" in question here pertained to contingent escalations in the price of "flowing" gas as per

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[15] 502 F.2d 461 (1974).

orders of the Commission in previous area rate proceedings. The waiver, if effected, would only reduce the anticipated (but undetermined) revenue from future sales of "flowing" gas in the particular area, to be offset by anticipated (but undetermined) future sales of new gas dedicated to the interstate market at higher fixed rates than those set in the area rate proceedings. The use of such an optional incentive program in no way deprives a producer of a *vested right* to participate in a *sum certain* (i.e. the relief of the liability to make cash payments equal to the aggregate amount of the refund obligations) which affects such producer's capital structure. The "waiver" in question in *Moss, supra*, pertained solely to "contingent escalation clauses," and not waivers of "work-off credits" against refund obligations definite in amount complained of in this case. Thus, no deprivation of *vested rights* was at issue in Moss and it was error for the Court below to rely on that case in an attempt to equate the two types of waivers.

CONCLUSION

Petitioner, Superior, prays the Court to grant the petition for a writ of certiorari for the reasons set forth above and to vacate those portions of Commission Order Nos. 699 and 699-H requiring a producer to enter into a replacement or renewal contract in situations where the existing contract has expired by its own terms and those requiring a waiver of work-off credits to discharge refund obligations established in previous area rate proceedings in order to qualify for the new national natural gas rate.

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By .....
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April 12, 1976

CERTIFICATE OF SERVICE

The within Petition for a Writ of Certiorari of The Superior Oil Company was served on all counsel of record by mail this 12th day of April, 1976.

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Pat F. Timmons